Weekly Updates Issue # 607

1. Weekly Markets Changes

[March 24, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,442.67 -47.82 -0.31%	2,343.98 -34.27 -1.44%	20,596.72 -317.9 -1.52%	5,828.74 -72.26 -1.22%	$0.7472 -0.19¢ -0.25%	$1,243.30 +14.40 +1.17%	$48.14 -0.58 -1.19%

2. Inflation ticked lower in February

[March 24, 2017] The annual pace of inflation in Canada ticked lower in February as higher prices for gasoline were offset in part by lower costs for fresh fruit and vegetables.

Statistics Canada said Friday that the consumer price index rose 2% on a year-over-year basis in February, compared with a 2.1% increase in January. Economists had expected it rise 2.1% in February as well.

Nick Exarhos, director at CIBC World Markets, says in a research note, "Canadian inflation has warmed up, but took a breather in February. […] With the headline rate coming in a bit soft versus consensus, and the ex-food and energy measure decelerating a few ticks to 2%, the CPI common failed to make any headway and was stuck at 1.3%."

Prices were higher in seven of the eight major components, with food the only one to decline. Excluding gasoline, the February consumer price index was up 1.3% compared with a year ago following a 1.5% in January.

Transportation costs gained 6.6% compared with a year ago, boosted by a 23.1% rise in gasoline _ which was at an unusually low level in early 2016. Shelter costs rose 2.2%.

Food costs fell 2.3% as prices for food bought from stores fell 4.1%. Prices for food bought from restaurants rose 2.3% but fresh vegetables dropped

14.0% and fresh fruit slipped 13.3%, partly reflecting a spike in prices last winter.

The annual pace of inflation slowed in seven provinces on a year-over-year basis in February while Ontario and B.C. both held steady at 2.3%. Manitoba was the only province to show an increase in the annual pace of inflation as it increased to 2.3% compared with 2.1% in January.

Statistics Canada said the Bank of Canada's three preferred measures for core inflation saw year-over-year increases last month of 1.3%, 1.9% and 1.6%.

3. Feds will keep asking for more to bolster middle class: Morneau

[March 24, 2017] "It is not lost on me that, for many in this room, our plan has asked more from you," said Finance Minister Bill Morneau during a post-budget speech on Friday in Toronto.

Still, Morneau delivered a clear message to Toronto's business community: the government will continue to ask for more as they focus on doing "more for the middle class and those working to join it."

Morneau said the middle class is comprised of "nearly 9 million Canadians," and he shared a story about how a taxi driver recently thanked him on behalf of his family; the man and his wife have three young children, and now receive more help via the Canada Child Benefit. (The benefit is estimated to cost taxpayers $22.4 billion in 2017-18, an increase of $4.3 billion over the previous child benefit system.)

The government has taken aim at associated corporations and billed-basis accounting, for example. Going forward, there will be a review of the current tax code with a particular focus on high-income strategies.

During a post-speech Q&A, Advisor.ca asked Morneau about this pending review. In response, the finance minister reiterated the budget's note that the tax system should operate "as fairly and effectively moving forward," citing there will be particular focus on the "increased number of private corporations" that are using complex tax strategies.

As the budget states, Morneau said the government's concerned with "at least" three items; those are income sprinkling, the use of passive investments in a private corporation and the conversion of dividends to capital gains. Morneau said a report will be released soon but couldn't provide a date, and mentioned that report will provide more on which of those items is the main focus.

Morneau also fielded questions about the hot housing market, parental leave and the KeyStone XL pipeline, which is one way to get the “best price for our products” and capitalize on our natural resources strength.

Regarding housing, he said there are no new measures on the way to cool markets, given steps taken to increase down payments and bolster mortgage stress testing have been effective. But he’ll be monitoring the sector.

4. Budget changes donation rules

[March 24, 2017] This year’s budget included a few notes relating to charitable giving and donations. The goal, says Curtis Davis, is to start simplifying the tax code.

Davis, who’s director of tax and estate planning at Mackenzie Investments in Toronto, highlights the budget’s mention that the First-Time Donor’s Super Credit will expire at the end of 2017 as planned.

He suggests, “It was only a $250 credit on the first $1,000 donation, and spouses could share it, but the max was $250. That’s not a huge loss, but make your first donation by the end of this calendar year if you want to use it.”

Aside from that, the government’s biggest proposed change is to the ecological gifts program, which is managed by Environment and Climate Change Canada (ECCC). Under that program, donations of ecologically sensitive land are eligible for special tax assistance; easements, covenants or servitudes on such lands are known as ecogifts.

In a nutshell, individual ecogift donors can claim a charitable donation tax credit, while corporate donors are eligible for a deduction. Up to the full amount of a donation can be claimed in the first year, while unused amounts can be carried forward for 10 years (prior to 2014, amounts could only be carried forward for five years). In most cases, capital gains are exempt from tax.

This sounds like a great deal.

And, for the most part, the government has no qualms with the program—in Quebec, the budget even proposes to encourage more ecogifts through making it possible for “certain donations of personal servitudes [to] qualify as ecogifts.”

However, there are a few changes of note, says Davis.

A 2013 document from Environment Canada gives examples of several types of land to which the ecogifts program applies, as well as ways in which people have been able to donate (note that this document pre-dates Budget 2017, so some information may be dated). Woodlots and properties that are home to large varieties of wildlife and vegetation, and coastal lands that are nesting grounds for birds are referenced as types of land.

The Liberals have proposed expanding the 50% tax that is currently imposed when a charity receives a gift of ecologically sensitive land, and then changes the land's purpose or disposes of it without the consent of the ECCC, he explains. If that occurs, "the recipient is subject to a tax of 50% of land's fair market value."

The problem, says Davis, is the government says this tax isn't always imposed if an organization that receives eco-sensitive land changes or disposes of that land after the land has been transferred from another organization for consideration, or payment. The government wants to make sure organizations are incentivized to continue to protect land no matter how it changes hands.

For example, says Davis, "there's the opportunity to do split receipts [when] I donate land. There were scenarios where people donated and while part of [the land] was a gift, they also received money, or consideration, for part of it. The government says [people] can get a receipt for the value of gift but there's no receipt where they receive consideration."

As a result, says Davis, "this is a hint that maybe there were ways to structure [transactions] between organizations for consideration, where the receiving organization could then change the use of land or dispose of it without consent. It sounds like there were scenarios that came up," and thus the Liberals wanted to close the loophole.

The impact of this change will be small, says Davis, who says he's never dealt with these types of gifts personally. There are several hurdles when dealing with ecogifts, he adds: when they're donated, ECCC approvals are case-by-case, as is the valuation of the gifts themselves. "It's a very niche area of giving," explains. "Still, the government wants to protect sensitive land."

Other proposed changes to the program include:

- If municipalities receive ecogifts, they will now have to be approved as a recipient by the ECCC on a case-by-case basis. Before, they were automatically approved. This is "a formality change," says Davis.
- Private corporations could no longer accept ecogifts. "The concern there is often the donor is related to the board of directors [of the corporation]. Think of a family foundation. […] The Liberals saw that as a conflict of interest."

5. How Finance might curb tax advantages for private corps

[March 23, 2017] Business owners may think of themselves as middle class, but according to the Trudeau government, they aren't.

In its 2017 federal budget, "Building the Middle Class," the government reveals it will be reviewing how private corporations create unfair advantages for "high-income individuals."

And what exactly is a "private corporation"? While the budget doesn't specifically define the term as Canadian-controlled private corporations, our experts agree that CCPCs are being targeted.

"I read between the lines," says Paul Woolford, tax partner with KPMG Enterprise in Toronto.

"A private corporation that's Canadian-controlled has a low tax rate on the first $500,000 of business income."

The budget documents specifically point to three strategies used by private-corporation owners. Let's look at each in detail, and how the Department of Finance might address them.

What is a Canadian Controlled Private Corporation?

The Income Tax Act defines a CCPC by saying what it's not. For instance, it's not:

- controlled by non-residents,
- controlled by public or publicly traded corporations, or
- listed on a designated stock exchange.

Income sprinkling

What it is: This happens when a business owner has adult children and/or a spouse in lower tax brackets and makes them shareholders of her company, either directly or via a family trust as beneficiaries. When the business pays dividends to those shareholders, they pay taxes on those dividends at a lower rate than the business owner.

"The tax objective would be to reduce the family income tax liability," says Woolford.

This can also occur if a business owner does an estate freeze, taking preferred shares and having her children (or the trust) own common shares. That way, future growth and dividend income go to the children. Again, it's possible that the children are in lower tax brackets, and therefore the family unit pays less tax overall.

Nancy Graham, portfolio manager with PWL Capital in Ottawa, points out that corporate tax has already been paid on the dividends, since dividends are paid out of profit.

Non-tax reasons to do it: Woolford says that family members as shareholders is fairly common. And there are plenty of non-tax reasons for it. Estate freezes, for instance, assist with succession planning and allow the principal shareholder to plan for a fixed tax liability. And, he says, "it enables insurance and other planning opportunities to come into play that protect the estate and the individual. None of that, in my mind, is offensive. That's just good planning."

Besides, Graham says that, in her experience, there's a limited window for business owners to sprinkle income in the first place.

"You only do it when you have a big differential in tax rates," she says. "The big differential is probably in the first $60,000 a year of people's income."

And she points out that once children start making their own income – usually during post-secondary or a few years after graduating – the tax advantages of paying them dividends are much lower or eliminated altogether.

How it could be curtailed: Finance could disallow letting family trusts own shares of CCPCs, suggests Woolford, or you can only income sprinkle to a certain level.

As for family members who own shares directly, "it's difficult for me to understand how the government could restrict who owns the shares of a viable business," he says. Since that might not be possible, "what they might do is if a family member owns the shares, then [the shares] will be capped to the dividend rate equal to the market, which might be 6%."

Graham says if Finance cracks down on family share ownership, it could lower the appetite for people to start businesses. "There are a lot of people who are doing entrepreneurial things for whom this would be a hit," she says.

For its part, the budget document says, "In addressing these issues, the government will ensure that corporations that contribute to job creation and economic growth by actively investing in their business continue to benefit from a highly competitive tax regime."

Holding passive investments in a private corporation

What it is: Our experts agree that this refers to CCPCs changing their character so they are no longer CCPCs. Why is that advantageous?

CPCCs are subject to a refundable tax regime that initially taxes passive investment income at around 50%. Some of that is later refunded if the corporation pushes out dividends, at a rate of $1 for each $3 of taxable dividends paid. But it's not always feasible to pay dividends to shareholders.

Non-CCPCs do not fall under this regime.

"If a corporation that earns passive investment is not a CCPC, it would benefit from a much larger tax deferral," says Alexandra Spinner, partner at Crowe Soberman LLP in Toronto. "In Ontario, it would only pay 26.5% corporate tax, and not pay the personal level of taxation until those dividends are withdrawn."

She emphasizes that taxes are only deferred, not saved.

Non-tax reasons to do it: In some cases, the owner of a CCPC may genuinely leave Canada and become a non-resident. In that case, the corporation she controls is no longer a CCPC, and incidentally can take advantage of the lower tax rate on passive investment income.

How it could be curtailed: Woolford, who says that CCPCs changing character for tax reasons is uncommon, suggests that Finance may tighten the rules on who can hold non-CCPC shares.

Currently, the Income Tax Act only defines what a CCPC is not, rather than what it is.

Converting dividends to capital gains

What it is: There are several ways private companies can do this. Here are some examples.

If a family trust owns shares that have gained in value, and the trust has been in place longer than two years, it can sell the shares and allocate the capital gain among family members, says Woolford. The family members can then use their individual lifetime capital gains exemptions (worth $835,716 for 2017) to shelter the gains. (The corporation must qualify as a CCPC and carrying on an active Canadian business in Canada.)

Another way: intercorporate dividends between Canadian companies can be tax-free if they're paid out of what's known as safe income, says Woolford. (In brief, safe income is "earnings that have been taxed in a company and retained," he explains.) But if you pay a dividend to a corporate shareholder greater than a company's safe income, the excess could be re-characterized as a capital gain. That means the ultimate individual shareholder may ultimately pay capital gains tax, instead of dividends tax, on the excess.

Non-tax reasons to do it: For the first example, the trust could be selling its shares because the owners are exiting the business. For the second example, it may be necessary to pay dividends in excess of safe income if the shareholder recently bought shares and hasn't accumulated sufficient safe income.

How it could be curtailed: Finance could make it so there's only one long-term capital gains exemption per family unit, suggests Wolford. And it could further tighten the safe income rules (that section of the Tax Act, 55(2), was also examined in the 2016 federal budget). "And they're already pretty tight," Woolford says.

6. Niche nuggets in Budget 2017

[March 23, 2017] Tax expert John Sliskovic is more enthusiastic about the government's pending review of the current tax system than he is about Budget 2017.

"What caught our eye the most was the comments about the government releasing a paper that will talk about some of the issues that concern them," says Sliskovic, who's a tax partner for the Private Client Services Practice at EY in London, Ont. (See pages 199 to 200 of Budget 2017). "We're curious where [the government] might go with this, and that would be relevant to advisors."

In the meantime, the government has done "some smaller housekeeping," says Curtis Davis, director of tax and estate planning at Mackenzie Investments in Toronto, who's looking forward to the fall economic update. "What potentially put some bigger changes on hold might have been the political climate in the U.S., given their policies can have such a huge impact on our economy."

For now, the experts suggest sharing these highlights with clients who are impacted by the budget.

Disability Tax Credit and medical expenses

With the Disability Tax Credit (DTC), there's only one proposed change: the budget wants nurse practitioners to be added to the list of eligible medical practitioners that can certify the impacts of impairments for those applying for the credit.

"This is a good thing," says Davis. "In some provinces, the profession of a nurse practitioner is pretty prevalent, so their role is important in various communities." Nurses are regulated and recognized, similar to doctors, he adds, and they often have closer relationships with patients—that could be the case in rural communities, for example, where there aren't as many doctors.

This change will help clients who are applying for the first time or who have to reapply for the credit. Says Davis: "Eligibility can change," depending on the disability. Think of something like diabetes and the differing needs of children versus adults, he adds, noting, "There is the possibility of being assessed and re-assessed for the credit."

Sliskovic says the tweak to the DTC may be helpful if clients currently have trouble reaching their doctor, and a nurse practitioner is more readily available. "We have a handful of clients who do claim the credit. The form that the medical practitioner has to complete is fairly detailed but, normally, if you're able to get a hold of a doctor, it can get turned around pretty quickly." It typically takes a few weeks.

Going forward, we could see more changes to the DTC application process, says Davis. "I've heard it's quite an ordeal to go through the certification. It would have been nice to see some potential changes there, given it's a crucial credit for those with disabilities."

Regarding the Medical Expense Tax Credit, the budget's focus is on the costs of fertility treatments, and other medical interventions and medications for those trying to conceive.

"Those costs have always been eligible, but the challenge was it required the diagnosis of a condition, and that requirement has been dropped," says Davis. Starting in 2017, any family can now claim these costs and, going forward, can look back up to 10 years—this compares to a two-year window for many other credits, Davis adds.

He cites the high cost of fertility treatments as a main driver of this change, also noting, "The Liberals are very focused on supporting families of all types."

RESPs and RDSPs

The budget proposes that the anti-avoidance rules that apply to registered plans like RRSPs, TFSAs and RRIFs also be applied to RESPs and RDSPs.

Sliskovic explains, "There are three components that we call the advantaged tax rules, prohibited investment rules and non-qualified investment rules, and they will all now apply to all of these plans, but the budget itself says these changes won't have wide application because most RESPs and RDSPs are just investing in conventional, marketable securities."

Davis agrees, noting, "Most financial institutions that administer these accounts weren't really allowing investments that weren't allowed in other registered plans anyway. There shouldn't be a high number of accounts that get trapped," so it's more to prevent people from taking advantage of the loophole.

One example of something that won't be allowed any longer is "when you try and swap an investment that's in a taxable with an investment, of equal value, that's in a registered account. Then, when you would dispose of the investment in the registered account, you've then avoided tax." The government will only allow swaps if you have an investment in a registered account that's no longer eligible; you can swap that for something that is eligible, until the end of 2021.

Don't forget about derivatives

Attention all day traders and portfolio managers: you may have noticed that the budget proposes that derivatives be treated differently when it comes to the timing of recognition of gains and losses on such instruments held on income account. The budget says, "Aside from the mark-to-market property regime applicable to financial institutions," there are no specific Income Tax Act rules that govern this.

Curtis Davis of Mackenzie Investments says, “There’s a particular strategy called straddling transactions. In the straddle, the idea is you have positions that are offsetting—say one position works out while the other loses—but what traders were doing was realizing loser positions in the current tax year and deferring winners to the future, and thus timing when they want to realize income.”

Now, he adds, you’ll have to realize losses and gains at the same time, “and these changes are targeted at specific investors” using complex strategies.

7. How to avoid factual control of a corporation? Avoid influence

[March 23, 2017] Clients should stay away from wielding influence over businesses they don’t want associated with their own corporations for tax reasons.

That’s the conclusion of tax advisors after reviewing Ottawa’s latest rules on factual control of private corporations, released in the federal budget on Wednesday.

“They’re going after schemes that really should be confined to one small business deduction but are taking advantage of the law,” says Paul Schnier, lawyer with Blaney McMurtry in Toronto.

The government’s 2017 budget says it is broadening the definition of factual (de facto) control of a private corporation after case law had narrowed it. The new rules, to be made effective immediately, will allow tax authorities to show factual control where a person has direct or indirect influence on a corporation other than their own. Where there’s factual control, the two corporations would be “associated,” and must be lumped together for determining tax thresholds like the $500,000 limit for the small business deduction.

Factual control

The 2017 budget responded to McGillivray Restaurant Ltd. v Canada, a 2016 court decision, which narrowed the definition of factual control to legal control rights such as changing the board of directors or its powers.

The government has now re-broadened the definition. Before the McGillivray decision, CRA could challenge cases based on whether there was influence, and that could be interpreted broadly.

For instance, perhaps someone held a significant amount of debt in another corporation. “The corporation owes you a lot of money and you said, ‘OK, unless you do what I want, I’m going to call on this debt,’” Schnier says.

Or perhaps someone is a large customer of another corporation, accounting for roughly half of its sales, and tries to influence its decisions. That person could also be exercising factual control of the corporation, Schnier says. It comes down to day-to-day influence over the company.

"If it's an arm's-length creditor, debtor relationship, or an arm's-length supplier or customer relationship, I don't think CRA's going to be concerned," Schnier says.

Family ties

Tax authorities are more concerned about family business structures, with different family members owning corporations to reap the tax benefits, tax advisors say.

Perhaps a family furniture company is structured such that one family member owns the business that manufactures desks, while another family member owns the one manufacturing chairs. That would be concerning to CRA.

Kevin Stienstra, senior manager of tax services for Grant Thornton in St. Catharines, Ont., says CRA is more interested in people who intentionally set up corporations to skirt the rules. A client who is simply a major customer or supplier for another corporation, and not exercising any influence, should not be a concern in terms of having factual control, Stienstra says.

"It's quite the leap to say they have de facto control over that business—typically they wouldn't deem them to be associated," Stienstra says. "It's more the related party context that they're looking at."

Grey areas

While family businesses may be more a focus for CRA, the lines are back to being blurred.

The Federal Court of Appeal decision had made the interpretation of factual control a little too clear for the government's liking, Schnier says. CRA and the government prefer that tax advisors have some doubt about where the line is—so that they stay further away from it.

"Now, CRA says, 'We want to put some doubt in tax advisors' minds, so you don't really know what we're going to challenge, or not,'" Schnier says. "They're happy about it going back to being a grey area."

Wilmot George, vice-president of tax, retirement and estate planning for CI Investments in Toronto, says the rule changes highlight the complexity of the law and the pitfalls of tax planning without an advisor.

"The small business deduction is a significant deduction for business owners," George says. "You've got to be very careful with de facto control and de jure [legal] control when you're looking at access to the small business deduction."

Tax review

The federal budget also announced a tax review of strategies for the use of private corporations and other advantages for "high-income individuals"—so tax advisors may want to brace for further changes.

That would be keeping with the approach of the Justin Trudeau government.
Stienstra says the clarification of the factual control rules follows several similar changes made in the 2016 budget, such as those for the specified corporation and partnership income rules.
Before those 2016 changes came into force, for instance, a partner could create a private corporation with the partnership paying the company as an independent contractor for services. The private corporation would not be part of the partnership and could claim the full small business deduction.
"It's kind of a continuation of the 2016 budget," Stienstra says. "There was a whole bunch of rules […] aimed at stopping taxpayers from multiplying the small business deduction limit."
He adds: "The government is looking at tax fairness, and I guess they see that these tax strategies are available primarily to more wealthy business owners as opposed to the middle class."

8. Taxes could cool the GTA housing market

[March 20, 2017] Canada's hot housing market, nowhere better exemplified than in the Greater Toronto Area, has caused much hand-wringing.
"There are legitimate worries about how long this can be sustained," says senior economist at TD Bank James Marple, in an economics report. "The farther prices and sales appear to move away from fundamentals, the more pronounced the risk of a correction. […] The vulnerability to housing correction is the main source of downside risk to the Canadian economy."
Scotiabank suggests, in a report, that any polices addressing soaring prices must address these underlying issues:

- Supply isn't keeping up with demand, despite the strength of housing starts in the GTA.
- Listings of existing homes are extremely low, due to factors such as the Toronto land transfer tax, the difficulty of finding another home to move to, and an aging population, which tends to stay put.
- House prices reflect a degree of speculation. That's because, based on the historical relationship between the sales-to-new listings ratio and price appreciation, current market conditions are more consistent with price appreciation in the 15% year-over-year range, roughly 10 percentage points lower than current readings.

Increasing supply could involve zoning amendments, increased density allowances, a streamlined development approval process and incentives to encourage more rental unit construction. However, these measures would take time.

More timely would be tackling speculation, suggests Scotiabank, including the strict enforcement of a capital gains tax if the home isn't a principal residence.

The report also suggests introducing a tax on sellers who flip a property within a certain time frame. Revenue from such a tax at the provincial level could be applied to reduce other taxes or be redirected to increase housing stock.

Ontario Finance Minister Charles Sousa also supports more punitive tax measures. He is urging Ottawa to change how capital gains from flipping are taxed.

In a letter to federal Finance Minister Bill Morneau on Friday, Sousa says that boosting the taxable amount above 50% could reduce the incentive for people to purchase homes on speculation. Morneau is set to release his latest budget on Wednesday.

Sousa says curbing speculative real estate purchases could help address dwindling housing affordability. Such a measure could also generate tax revenue to put towards other housing affordability initiatives, he adds.

"My primary focus is to address the concerns of middle class Canadians who are worried about buying their first home," the letter reads. "Additionally, it is important that the housing market remains stable, meaning that borrowers and lenders are resilient and able to withstand economic shocks."

Policy results in Vancouver

The Scotiabank report doesn't recommend a foreign buyer's tax for Toronto, considering foreign buyers represent fewer buyers in Toronto than in Vancouver (5% versus 10%, anecdotally, says the report). Further, it's not clear Vancouver's market will experience sustained cooling from the tax. Though foreign purchases fell sharply following the implementation of the tax, those purchases are now edging back up.

In fact, home prices seem to be picking up steam in Vancouver again, what with gains in the home price index month-over-month in January and February (using Teranet-National Bank HPI data).

Further, demand may be boosted by the B.C. government's interest-free loan program for first-time homebuyers and the enhancement of the first-time homebuyers' property transfer tax exemption.

Cooling in Vancouver's housing market is mostly because of ongoing erosion of affordability and other policy tightening measures, suggests the Scotiabank report.

These include a 3% luxury tax on home sales greater than $2 million, significant new investments in affordable housing, a ban on shadow flipping of properties, cash incentives to municipalities to speed up development approvals and a law allowing municipalities to tax vacant homes.

“It is premature in our view to argue that the foreign buyers’ tax has led to a sustained cooling of the Vancouver housing market,” says the report, compared to measures to more broadly slow speculation among both domestic and foreign buyers.

9. To raise or not to raise rates? What the BoC must consider

[March 20, 2017] Speculation on the next move by the Bank of Canada (BoC) suggests a rate hike is possible due to strong economic data.

In an economics viewpoint report, Desjardins senior economist Jimmy Jean notes that last year Canadian growth surpassed that of the U.S., except in Q2, which was affected by the forest fires in Alberta.

And, in an economics note, James Marple, senior economist at TD Bank, says the rebound in growth is mainly the result of a recovery in the oil patch. TD expects that recovery to continue in 2017, along with growth from the construction sector, thanks in part to residential real estate activity.

Job creation has also been strong, with the six-month average of job creation reaching 40,000 in January, an unprecedented level since the financial crisis. And the unemployment rate (6.6%) is the lowest since the crisis. Further, inflation measures aren’t far below target.

“If the output gap tightens faster than expected, [inflation] measures could well converge toward the 2% target in the not too distant future,” says Jean.

But the real estate market represents an economic risk. Referencing Toronto’s hot market, Jean says there may be macro-prudential tools announced by the provincial government to cool things on that front.

Though the BoC prefers real estate risk to be addressed by those types of measures rather than by monetary policy, the strong economic developments could mean “the death knell of the easing bias that appeared in October and was reaffirmed in January,” says Jean.

A case to keep rates steady

Despite the strong economic indicators, there are also some contrary ones, like the weakness in hours worked in Canada. Though hours improved in February, the pace of -0.3% year-over-year disappoints. Hours worked are important because they are the measure of labour input used in many conventional models, explains Jean.

Private investment is also low, with cuts in investment budgets for the energy sector accounting for much of the decline the last two years. Only 35% of sectors intend to increase investment in 2017, compared to about half of

sectors over the last two years. Though public investment will help offset weakness, that might not be enough.
"The sustainable growth idealized by the BoC implies an enhanced contribution from private investment and a simultaneous moderation of the contributions from households and real estate," says Jean. "Success still seems a long way off on this front."
In addition, real exports increased in only two of the five months to February. Though the Canadian dollar appreciated against most currencies last year, that trend has reversed since January.
The biggest concern for exports remains potential U.S. protectionism.
Says Jean: "A border adjustment tax as outlined by the Republicans would severely hamper the competitiveness of Canadian exporters. This would come on top of the erosion in tax competitiveness for Canadian companies, with the reforms that are on the horizon in Washington. A significant depreciation of the currency would be required to mitigate all these effects."
Given the Bank's desire to support rotation toward exports, which relies on a competitive exchange rate, Marple expects the Bank to remain on hold well into 2018.
Jean says the positive indicators support a possible change in tone when governor Poloz delivers his next speech on March 28, but, given the trade policy risks, easing may be a possibility after all.

Have a nice and fruitful week!